RECORD
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BRIEFS.

Supreme Court, U.S.
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No. 15-649

IN THE
Supreme Court of the United States

CASIMIR CZYZEWSKI, *et al.*,

Petitioners,

v.

JEVIC HOLDING CORP., *et al.*,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR RESPONDENTS

PETER S. PARTEE, SR.
RICHARD P. NORTON
HUNTON & WILLIAMS LLP
200 Park Avenue
52nd Floor
New York, NY 10166
(212) 446-4800

Counsel for Respondent The CIT Group/Business Credit, Inc., as Agent for the Lender Group

CHRISTOPHER LANDAU, P.C.
Counsel of Record
JAMES P. GILLESPIE, P.C.
JASON M. WILCOX
KIRKLAND & ELLIS LLP
655 Fifteenth St., N.W.
Washington, DC 20005
(202) 879-5000
clandau@kirkland.com

Counsel for Respondents Sun Capital Partners, Inc., Sun Capital Partners IV, LP & Sun Capital Partners Management IV, LLC

Additional Counsel on Signature Block

October 12, 2016

QUESTION PRESENTED

The petition for certiorari presented the following question:

Whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme.

CORPORATE DISCLOSURE STATEMENT

Respondent Sun Capital Partners, Inc. has no parent corporation and no publicly held company has a 10% or greater ownership interest.

Respondent Sun Capital Partners IV, LP, has no parent corporation and no publicly held company has a 10% or greater ownership interest.

Respondent Sun Capital Partners Management IV, LLC is wholly owned by Sun Capital Advisors IV, LP, and no publicly held company has a 10% or greater ownership interest.

Respondent The CIT Group/Business Credit, Inc. is a wholly owned subsidiary of CIT Group Inc., which is a publicly traded company. No individual shareholder holds 10% or more of the stock of CIT Group Inc.

Respondent Jevic Holding Corp. is wholly owned by Sun Transportation LLC and HIG Sun Partners, Inc., and no publicly held company owns 10% of more of its stock.

Respondent Jevic Transportation Inc. is a wholly owned subsidiary of Jevic Holding Corp., and no publicly held company holds 10% or more of its stock.

Respondent Creek Road Properties, LLC is a wholly owned subsidiary of respondent Jevic Transportation Inc., and no publicly held company owns 10% or more of its stock.

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INTRODUCTION

This is a contrived case. Petitioners were holdouts from a global settlement involving all other stakeholders in a Chapter 11 bankruptcy. Although the settlement left petitioners free to pursue the claims they refused to settle, they asked the bankruptcy court to reject the settlement, but failed to prove (or even to argue) that such rejection would leave anyone—*including petitioners themselves*—better off. The bankruptcy court made factual findings, which both the district court and the Third Circuit left undisturbed, that the alternative to this settlement was not confirmation of a Chapter 11 plan of reorganization, but conversion of this case to a Chapter 7 liquidation, with all of the estates' remaining assets being distributed in short order to the debtors' secured creditors, respondents The CIT Group/Business Credit, Inc., as agent for the Lender Group (CIT), and Sun Capital Partners IV, LP (Sun Fund IV). In other words, if petitioners succeed in overturning the settlement, they will not get a penny, but will wreak havoc on all other unsecured creditors (including priority creditors like federal and state taxing authorities and more than 1,000 general unsecured creditors) who received and cashed their distribution checks under the settlement three years ago.

Petitioners insist that this result is necessary to vindicate what they view as the proper operation of the Bankruptcy Code. As counsel for the U.S. Trustee, supporting petitioners, told the bankruptcy court: "'[W]e have to accept the fact that we are sometimes going to get a really ugly result, an economically ugly result, but it's an economically

ugly result that is dictated by the provisions of the code.'" Pet. App. 23a (quoting CA3 App. 1327). But federal courts sit to resolve "cases" or "controversies," not to vindicate an alleged interest in the proper operation of the law. Petitioners were repeatedly asked point-blank in the Third Circuit what relief they were seeking here, and repeatedly answered that it was conversion to a Chapter 7 liquidation. *See* Resps.' Supp. Br., Supp. App. 19-22a, 60a. In light of the bankruptcy court's factual findings, endorsed by both the district court and the Third Circuit, that petitioners would recover *nothing* in a Chapter 7 liquidation, this dispute does not present an Article III case or controversy.

And even assuming that this Court were to reach the question on which it granted certiorari—whether bankruptcy courts must apply the Code's priority system not only to *plans of reorganization* but also to *settlements* in Chapter 11—petitioners fare no better. The Code's plain text applies the priority system to a "plan," 11 U.S.C. § 1129(b)(2)(B)(ii), but there is no corresponding provision for a settlement. The Fifth Circuit decision on which petitioners relied in their petition, *In re AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984), identified no textual basis for its approach, but instead invoked "policy arguments," *id.* at 298. As the Second Circuit noted in *In re Iridium Operating LLC*, 478 F.3d 452, 464 (2d Cir. 2007), and the Third Circuit reaffirmed here, "policy arguments" cut *against* the Fifth Circuit's atextual *per se* rule, and favor a more pragmatic approach that, in rare cases, allows bankruptcy courts to approve settlements that do not follow the Code's priority system. Indeed, nothing in the Code either authorizes or requires bankruptcy courts to review

and approve Chapter 11 settlements in the first place, so it follows *a fortiori* that nothing in the Code authorizes or requires such courts to apply the priority system to such settlements.

Understandably reluctant to defend the *AWECO* rule underlying the alleged circuit conflict on which they sought and obtained this Court's review, petitioners now try to change the subject entirely. Thus, they focus their merits argument not on the applicability of the Code's priority system to settlements, but instead on the validity of "structured dismissals" under which a bankruptcy court dismisses a Chapter 11 case "for cause" under 11 U.S.C. §§ 349(b) and 1112(b). Indeed, petitioners alter the question presented by replacing a reference to a "settlement" with a reference to a "structured dismissal," *compare* Pet. i *with* Petrs.' Br. i, and relegate the only reference to *AWECO* in the argument section of their merits brief to a passing footnote, *see id.* at 32 n.6. The validity of a structured dismissal is not fairly included within the question presented in the petition, and there is no circuit conflict on that issue; to the contrary, neither *AWECO* nor *Iridium* involved a structured dismissal at all. This Court's rules do not allow such transparent "bait and switch" tactics, and respondents certainly will not take the bait.

That point brings back matters full circle to the starting point of this brief: this is a contrived case. Petitioners will not benefit from a favorable ruling, but challenged the settlement below in the hopes of obtaining an advisory opinion "that people can count on and negotiate against in bankruptcy." Resps.' Supp. Br., Supp. App. 60a. The crux of that

challenge below was that the settlement does not satisfy the legal standard set forth by the Second Circuit in *Iridium*, which, as the Third Circuit noted, petitioners "cite throughout their briefs and never quarrel with." Pet. App. 19a. After the Third Circuit adopted and applied the *Iridium* standard, petitioners sought and obtained this Court's review by challenging that standard as inconsistent with the Fifth Circuit's decision in *AWECO*. At the merits stage, petitioners now ask this Court to rule on the validity of "structured dismissals," although that issue does not implicate the circuit conflict cited in their petition and is not fairly included in the question presented. Enough is enough. This Court should either dismiss the case for lack of jurisdiction, or affirm the judgment on the merits.

PERTINENT STATUTORY PROVISIONS

Petitioners have included pertinent statutes and rules in an Appendix to their merits brief. Excerpts from other pertinent statutes, the Bankruptcy Act of 1898, 55th Cong., 2d Sess., 30 Stat. 544 (1898), and the Act of June 22, 1938, 75th Cong., 3rd Sess., 52 Stat. 840 (1938), are reproduced in a Supplemental Appendix ("Supp. App.") attached to this brief.

STATEMENT OF THE CASE

A. Background

Respondent Jevic Transportation, Inc. was a New Jersey trucking company. Pet. App. 2a. In 2006, as the company teetered on the brink of insolvency, it was acquired by respondent Sun Fund IV in a buyout financed with a loan later refinanced by a group of lenders led by respondent CIT and secured by a lien on all of Jevic's assets. *Id.*; Pet. App. 53a; JA230.

Jevic's fortunes, however, failed to improve, and in January 2008, the company reached a forbearance agreement with CIT—which included a $2 million guarantee by Sun Fund IV—to prevent foreclosure. Pet. App. 2a. As Jevic's situation worsened in early 2008, Sun Fund IV was forced to make a $2 million guarantee payment to CIT, and thereby acquired its own $2 million secured lien on Jevic's assets. JA206.

With the advent of the Great Recession in the spring of 2008, Jevic's board of directors decided to seek bankruptcy protection. Pet. App. 2a. On May 19, 2008, the company ceased substantially all operations, and its employees received termination notices. *Id.*; JA206.

B. Proceedings Below

1. Bankruptcy Court

The next day, Jevic and two affiliated companies filed voluntary Chapter 11 petitions in the U.S. Bankruptcy Court for the District of Delaware. Pet. App. 3a. At that time, Jevic owed about $53 million to its secured creditors, respondents CIT and Sun Fund IV, and over $20 million to its unsecured creditors, including tax and general creditors. *Id.*; JA206. The U.S. Trustee thereafter appointed the Official Committee of Unsecured Creditors to represent Jevic's unsecured creditors.

Because Jevic had no real prospect of reorganizing, it began the process of liquidating its assets to pay its creditors. Pet. App. 36a. (As petitioners acknowledge, Chapter 11 authorizes liquidation as well as reorganization under certain circumstances. *See* Petrs.' Br. 7 (citing 11 U.S.C. § 1123(b)(4)). CIT provided post-petition debtor-in-possession financing

to fund this asset-sale process. JA206. Jevic's prior obligations to CIT were "rolled up" into this new financing facility. Pet. App. 54a; JA206-07. Under the terms of this financing, Jevic agreed to waive any challenge to the validity, enforceability, or priority of CIT's secured claims, but the Committee was granted standing to step into Jevic's shoes to raise those challenges. JA23-24, 231. The Committee then brought a fraudulent conveyance action on behalf of the Jevic bankruptcy estates against CIT, Sun Fund IV, and two other Sun entities, respondents Sun Capital Partners Management IV, LLC and Sun Capital Partners, Inc. (SCPI), arising from the leveraged buyout of Jevic. Pet. App. 3a.

In addition, petitioners (former Jevic employees) brought a class action against Jevic and SCPI (on a putative "single employer" theory) seeking forward-looking statutory damages under the Worker Adjustment and Retraining Notification Act (WARN), 29 U.S.C. § 2102, and its New Jersey state-law counterpart, which generally require employers to provide workers with 60 days' notice before termination. Pet. App. 3a. Separately, individual employees also filed claims "for unpaid wages and benefits" accrued through their date of termination. Pet. 2. Jevic paid in full all of its former employees' claims for unpaid wages and benefits through the date of their termination, including $3 million in accrued vacation and health insurance benefits. JA206, 226-27.

In September 2011, the bankruptcy court (Shannon, J.) granted in part and denied in part a motion to dismiss the Committee's fraudulent conveyance action. JA20-52. The court dismissed

the claims for fraudulent transfer under 11 U.S.C. § 544, for equitable subordination of CIT's $53 million claim against the Jevic bankruptcy estates, and for aiding and abetting Jevic's officers and directors in allegedly breaching their fiduciary duties. JA43-44, 47-51. At the same time, the court concluded that the Committee had adequately pleaded preference and fraudulent conveyance claims under 11 U.S.C. §§ 547 and 548. JA36-42, 44-47. Despite holding that these claims survived dismissal on the pleadings, the court acknowledged that the defenses "may ultimately prove fatal" to the claims, and that "the Committee will still need to marshal evidence" to overcome those defenses. JA35, 39.

Soon thereafter, the parties sought to settle the long-running fraudulent conveyance action and wrap up the entire bankruptcy. Pet. App. 4a. By then, the Committee was wary about continuing to pursue what would likely be "very protracted and expensive" litigation against well-funded adversaries. JA232, 235. Because discovery was in the earliest stages and the "long litany of affirmative defenses" raised posed "significant obstacles" to any recovery, the Committee recognized that litigating the claim to judgment would take years and cost millions of dollars. JA233-36. The Jevic bankruptcy estates were administratively insolvent, had no unencumbered assets to fund the litigation, and could not secure trial counsel willing to take the case on a contingency basis. JA207-08, 233, 235.

The settlement negotiations initially involved all major economic stakeholders, including Jevic, the Committee, the Sun entities, CIT, and petitioners.

Pet. App. 55a, 59a. Jevic made "numerous efforts" to include petitioners in the settlement. JA210, 222. But petitioners refused to join the settlement of the fraudulent conveyance claim unless they also received what they believed to be the full value of their WARN claim against SCPI. JA233. Sun, however, was unwilling either to accede to this attempt to "hold up" the fraudulent conveyance settlement as leverage to settle what Sun believed to be a meritless claim (as it was ultimately determined to be), or to enter into a partial settlement with petitioners that would fund the ongoing WARN litigation. JA245-46. As a result, the final settlement agreement resolved all disputes among all stakeholders *except* petitioners, who chose to continue pursuing their WARN claims against SCPI and Jevic rather than participate in the settlement of the estates' fraudulent conveyance claim. *See* Pet. App. 59a ("It is clear that the [WARN] claimants were invited to and took part in th[e] settlement process, but they have chosen not to be part of this settlement.").

In June 2012—pursuant to Third Circuit precedent that requires bankruptcy court approval of all settlements in Chapter 11, *see, e.g.*, *Northview Motors, Inc. v. Chrysler Motors Corp.*, 186 F.3d 346, 351 n.4. (3d Cir. 1999); *In re Martin*, 91 F.3d 389, 393 (3d Cir. 1996); *see generally* Fed. R. Bankr. P. 9019—respondents filed a joint motion asking the bankruptcy court to (1) approve their settlement, and (2) dismiss the Chapter 11 cases upon implementation of the settlement. *See* JA158-82. Under the settlement, in exchange for dismissal of the fraudulent conveyance action, CIT agreed to pay $2 million into an account earmarked for the estates'

unpaid administrative expenses, and Sun Fund IV assigned its lien on Jevic's remaining $1.7 million in cash to a trust, which would first pay various priority unsecured creditors and then pay general unsecured creditors on a *pro rata* basis. JA186-92; *see also* Pet. App. 5a.

Petitioners objected to the proposed settlement. However, at a November 2012 evidentiary hearing, they presented no evidence of their own, and mounted no real challenge to any of respondents' evidence. Instead, petitioners insisted that the settlement was invalid as a matter of law because it did not follow the Code's priority system insofar as it allocated proceeds to general unsecured creditors but not to petitioners, who held a disputed priority unsecured claim (their WARN claim) against the Jevic estate.

The bankruptcy court rejected that argument. In an oral ruling in December 2012, the court acknowledged that "the proposed distributions are not in accordance with the absolute priority rule" because some settlement funds flowed to general unsecured creditors with a lower statutory priority than petitioners. Pet. App. 58a. That point, however, was not dispositive: "[B]ecause this is not a plan, and there is no prospect here of a confirmable plan being filed, the absolute priority rule is not a bar to approval of this settlement." *Id.*

The bankruptcy court proceeded to approve the settlement based on "dire circumstances." *See* Pet. App. 45-52a, 53-66a. In particular, the fraudulent conveyance claim was a long shot that the bankruptcy estates lacked funds to pursue and was an unattractive case for contingency counsel. Pet.

App. 61a ("[O]n these facts I think any lawyer or firm that signed up for that role should have his head examined."). Neither petitioners nor their counsel ever offered either to fund the litigation or to act as contingency counsel. Nor did they ever assert any interest in pursuing an individual fraudulent conveyance claim or ever ask the court to dismiss the case with no strings attached in order for them to do so.

In addition, the bankruptcy court held that dismissal of the Chapter 11 cases was appropriate because there was no feasible alternative and nothing further for the court to do in light of the settlement. The Chapter 11 cases had "been pending for years ... with no reasonable prospect of a confirmable plan." Pet. App. 56a. There were "no assets or funds that are not subject to the liens of CIT and Sun Capital," no "resources to creditably prosecute the Committee's lawsuit," no "resources to, otherwise, wrap up these bankruptcy proceedings," and no reasonable prospect of a meaningful "distribution to unsecured creditors" absent the settlement. *Id.* Aside from the pending fraudulent conveyance action, "[a]ll material tasks needed to administer the estates ha[d] already been completed." *Id.*

Nor was conversion to a Chapter 7 liquidation a feasible alternative. A Chapter 7 trustee would have no "money to operate, investigate or litigate" the claims, and the secured creditors, respondents CIT and Sun Fund IV, "have stated unequivocally and credibly that they would not do this deal in a Chapter 7." Pet. App. 58a. Thus, in the event of a Chapter 7 conversion, "the settlement proceeds

would be taken by the secured creditors in relatively short order ... with nothing left over for stakeholders." *Id.* Faced "with two options, a meaningful return or zero," the court chose the former. Pet. App. 61a.

Petitioners thereafter moved for a stay pending appeal in the bankruptcy court. After the bankruptcy court denied that request, however, petitioners did not seek a stay from the district court. Pet. App. 38a. In August 2013, respondents consummated the settlement, distributing 29 checks to various federal and state taxing authorities and more than 1,000 checks to general unsecured creditors. Pet. App. 39a. The bankruptcy court dismissed Jevic's Chapter 11 case on October 11, 2013. *Id.*

Meanwhile, in May 2013, the bankruptcy court issued two important rulings in the ongoing WARN litigation. *First*, the court granted SCPI summary judgment on the ground that it was not a "single employer" with Jevic for purposes of WARN liability under either federal or state law. *See In re Jevic Holding Corp.*, 492 B.R. 416, 433 (Bankr. D. Del. 2013). Both the district court and the Third Circuit subsequently affirmed that decision. *See* 526 B.R. 547 (D. Del. 2014); __ F. App'x __, 2016 WL 4011149 (3d Cir. July 27, 2016). *Second*, the bankruptcy court held that petitioners failed to establish liability against Jevic under the federal WARN Act (which contains an exception for "business circumstances that were not reasonably foreseeable as of the time that notice would have been required," 29 U.S.C. § 2102(b)(2)(A)), but had established liability against Jevic under the New Jersey WARN Act (which

contains no such exception). *See In re Jevic Holding Corp.*, 496 B.R. 151, 165 (Bankr. D. Del. 2013).

2. District Court

Petitioners appealed the bankruptcy court's order approving the settlement to the district court, which affirmed in January 2014. *See* Pet. App. 35-43a. (Although the U.S. Trustee had also objected to the settlement in the bankruptcy court, it did not appeal the bankruptcy court's order.) The district court concluded that the bankruptcy court had not abused its discretion by deciding on this record that the settlement "was in the best interest of the estate and of resolving the pending Chapter 11 cases." Pet. App. 40-41a (citing *Martin*, 91 F.3d at 393).

In particular, the district court agreed with the bankruptcy court that the absolute priority rule, codified in 11 U.S.C. § 1129(b), applies only to Chapter 11 *plans*, not *settlements*. Because a settlement "is not a reorganization plan," it is subject only to the "criteria for approval under Bankruptcy Rule 9019 and the standards set forth under *In re Martin*." Pet. App. 42a (internal quotation omitted).

The district court held in the alternative that the appeal was equitably moot, applying a prudential doctrine recognized by the Third Circuit and several other courts of appeals in bankruptcy cases. *See, e.g., In re Semcrude, L.P.*, 728 F.3d 314, 321 (3d Cir. 2013); *Duff v. Central Sleep Diagnostics, LLC*, 801 F.3d 833, 840 (7th Cir. 2015); *In re Charter Commc'ns, Inc.*, 691 F.3d 476, 479 (2d Cir. 2012). The district court held that (1) the settlement had been substantially consummated because all funds had been distributed; and (2) if petitioners' appeal succeeded, (a) the settlement would be irreversibly

scrambled, "as it did not provide for funds for appellants' speculative recovery and appellants chose not to substantively participate in the negotiation and subsequent settlement," and (b) the parties had negotiated a resolution "following years of litigation and will be harmed if the settlement is now unwound." Pet. App. 43a.

3. Third Circuit

Petitioners again appealed, and the Third Circuit affirmed. Pet. App. 1-32a. The court adopted the legal standard set forth by the Second Circuit in *Iridium*—"which, we note, [petitioners] ... cite throughout their briefs and never quarrel with." Pet. App. 19a. Under that standard, "bankruptcy courts may approve settlements that deviate from the priority scheme of § 507 of the Bankruptcy Code," but "*only* if they have 'specific and credible grounds to justify [the] deviation." Pet. App. 21a (emphasis added; quoting *Iridium*, 478 F.3d at 466).

Applying the *Iridium* standard, the panel majority held that this was the "rare" case in which a bankruptcy court had discretion to approve a Chapter 11 settlement that did not follow the Code's priority system. Pet. App. 2a, 12a, 23a. The majority based that conclusion on the bankruptcy court's factual finding that the settlement here was "the least bad alternative since there was 'no prospect' of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order.'" *Id.* at 21a (quoting Pet. App. 58a); *see also* Pet. App. 23a (highlighting the bankruptcy court's "sound findings of fact that the traditional routes out of Chapter 11 are unavailable and the

settlement is the best feasible way of serving the interests of the estate and its creditors"). "As in [*Iridium*], here the Bankruptcy Court had to choose between approving a settlement that deviated from the priority scheme of § 507 or rejecting it so a lawsuit could proceed to deplete the estate." Pet. App. 22a.

Judge Scirica concurred in part and dissented in part. As relevant here, he agreed with the majority's decision to "adopt the Second Circuit's standard from [*Iridium*]." Pet. App. 24a. He differed with the panel majority only with respect to the application of that legal standard to the facts of this case. Pet. App. 24-31a. In particular, he proposed unilaterally rewriting the settlement to provide petitioners a recovery in accordance with their statutory priority. Pet. App. 32a.

Petitioners sought rehearing *en banc*. *See* Br. in Opp., Supp. App. 1-17a. As relevant here, they did not challenge the panel's adoption of the Second Circuit's *Iridium* standard; rather, they argued only that the panel majority had *misapplied* that standard. *See id.* at 13-15a. Nor did petitioners argue that structured dismissals violate the Bankruptcy Code. *See* Opp. to Pet. for Rehearing En Banc at 10 n.1, *In re Jevic Holding Corp.*, 3d Cir. No. 14-1465 (Aug. 5, 2015). The Third Circuit denied the petition without recorded dissent. *See* Pet. App. 67-68a.

Petitioners then sought this Court's review. The petition presented a single question: "Whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme." Pet. i. Petitioners

argued that "[t]here is a square and acknowledged split among the circuits" on that question. *Id.* at 15 (capitalization modified). On the one hand, they said, "[t]he Fifth Circuit has adopted a per se rule" under which bankruptcy courts may not approve a settlement that distributes estate assets in violation of the statutory priority scheme. *Id.* (citing *AWECO*, 725 F.2d at 298). On the other hand, they said, "[i]n the Second Circuit, ... a bankruptcy court may approve a pre-plan settlement that distributes estate assets in violation of the Code's priority rules." *Id.* at 16 (citing *Iridium*, 478 F.3d at 464). Petitioners argued that the Third Circuit erred by adopting the *Iridium* standard, which—according to petitioners—"cannot be squared with the text, structure, or purpose of the Code." *Id.* at 19. Petitioners thus urged this Court to "grant review and hold that settlement proceeds may not be distributed in violation of the Bankruptcy Code's priority scheme." *Id.* at 3.

As respondents pointed out in their opposition brief, petitioners had never challenged the *Iridium* standard in the Third Circuit. *See* Br. in Opp. 24; *see also* Resps.' Supp. Br. 4. In addition, respondents explained that the petition did not challenge structured dismissals, and indeed neither *AWECO* nor *Iridium* involved a structured dismissal. *See* Br. in Opp. 23 n.4; *see also* Resps.' Supp. Br. 3 n.1 (same). Petitioners did not dispute that point in their reply brief.

SUMMARY OF ARGUMENT

As the Third Circuit recognized, the bankruptcy court here acted well within its discretion by approving a Chapter 11 settlement that provided

some recovery for unsecured creditors, where the only feasible alternative was a Chapter 7 liquidation that would have provided *no* recovery for unsecured creditors (including petitioners).

That point has jurisdictional implications. There is no "case" or "controversy" within the meaning of Article III where, as here, petitioners cannot show that a favorable decision is likely to redress their alleged injury. Petitioners are simply seeking an advisory opinion on the proper operation of the Bankruptcy Code, but it is not the office of the Article III courts to expound on legal issues that will not benefit the parties invoking their jurisdiction.

Were this Court to reach the merits of the issue on which it granted review—the alleged conflict between *AWECO*, on the one hand, and *Iridium* and the decision below, on the other—it should affirm the decision below. As a threshold matter, nothing in the Code authorizes or requires bankruptcy courts to review and approve Chapter 11 settlements in the first place. The prior Bankruptcy Act did contain such a requirement, but it was scrapped when Congress adopted the Code in 1978 and limited the bankruptcy courts' involvement in the day-to-day administration of bankruptcy estates. And even assuming that the Code authorizes and requires bankruptcy courts to review Chapter 11 settlements, nothing in the Code specifies that such settlements must follow the Code's priority system. To the contrary, the Code's priority system applies to the treatment of dissenting classes of creditors under Chapter 11 *plans*. If Congress had wanted the Code's priority system to apply as well to Chapter 11 *settlements*, it could and would have said so.

Finally, this Court should reject petitioners' efforts to change the subject from the question whether bankruptcy courts must reject Chapter 11 settlements that do not follow the Code's priority system to the entirely different question whether a Chapter 11 case may ever terminate in a structured dismissal. The latter question has nothing to do with the circuit conflict identified in the petition, and is not fairly included in the question presented.

ARGUMENT

I. This Dispute Does Not Present A Justiciable "Case" Or "Controversy."

As a threshold matter, this dispute should be dismissed for lack of jurisdiction. Article III of the Constitution limits "[t]he judicial Power of the United States" to the resolution of "Cases" or "Controversies." U.S. Const. art. III §§ 1, 2. "[N]o principle is more fundamental to the judiciary's proper role in our system of government than the constitutional limitation of federal-court jurisdiction to actual cases or controversies." *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540, 1547 (2016) (internal quotation omitted).

This dispute does not present a justiciable "case" or "controversy" because petitioners have failed to show that respondents have caused them an injury in fact "that is likely to be redressed by a favorable judicial decision," and thus lack standing to sue. *Id.*; *see also id.* ("Standing to sue is a doctrine rooted in the traditional understanding of a case or controversy."). Petitioners are challenging the settlement of a fraudulent conveyance claim against respondents CIT, Sun Fund IV, and two other Sun entities. That claim, which belonged to the Jevic

bankruptcy estates, was brought by the Official Committee of Unsecured Creditors, which was granted derivative standing by the bankruptcy court to pursue the claim on the estates' behalf. *See* Order (6/20/08) ¶ 39 at 24, *In re Jevic Holding Corp.*, Bankr. D. Del. No. 08-bk-11006, Dkt. 118.[1] Only the Official Committee—not petitioners—had standing to litigate (and therefore to settle) that claim on behalf of the estates.

The problem with petitioners' challenge to the settlement is that they have failed to show how a decision in their favor would benefit them—in Article III parlance, how such a decision would redress their alleged injury. *See, e.g., Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 102-04 (1998). If a court cannot afford a litigant relief that is likely to redress such an injury, the court is essentially being asked to render an impermissible "advisory opinion" in violation of Article III. *Id.* at 101; *see also Summers v. Earth Island Inst.*, 555 U.S. 488, 492-93 (2009).

The bankruptcy court in this case specifically found that there was "no reasonable prospect of a confirmable [Chapter 11] plan," because the debtors "lack the resources to ... wrap up these bankruptcy proceedings." Pet. App. 56a; *see also id.* ("In the absence of the settlement that is before the Court it is a virtual certainty that there will be no distribution to unsecured creditors here, and a

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[1] Under Third Circuit law, a bankruptcy court may in certain circumstances grant an Official Committee derivative standing to pursue a claim on behalf of a bankruptcy estate. *See Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548, 552-53 (3d Cir. 2003) (*en banc*).

substantial shortfall for distributions to administrative creditors."). Thus, the settlement was not an end run around the requirements for confirmation of such a plan. Rather, the court determined, the only feasible alternative to this settlement was conversion of the case to a Chapter 7 liquidation. Pet. App. 56-58a.[2]

And conversion to a Chapter 7 liquidation, the bankruptcy court further found, would benefit neither petitioners nor any of the other unsecured creditors. Pet. App. 56-61a. "The lenders [*i.e.*, respondents CIT and Sun Fund IV] have stated unequivocally and credibly that they would not do this deal in a Chapter 7," the estates had insufficient funds to pursue the fraudulent conveyance case on their own, and private counsel was unlikely to accept the case on a contingency basis. Pet. App. 58a; *id.* ("[I]n the event of a conversion it does not appear that a Chapter 7 Trustee would have any money to operate, investigate or litigate."); Pet. App. 61a ("[O]n these facts I think any lawyer or firm that signed up for th[e] role [of contingency counsel] should have his head examined."). Thus, "I would say with a measure of confidence that the [estates' assets] would be taken by the secured creditors [*i.e.*, respondents CIT and Sun Fund IV] in relatively short order following a conversion [to] Chapter 7 with nothing left over for stakeholders." Pet. App. 58a; *see also* Pet. App. 57-58a ("In the absence of *this*

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[2] A Chapter 11 liquidation plan was not a feasible option because the estate was administratively insolvent and all plans must pay administrative and priority claims in full on the plan's effective date. *See* 11 U.S.C. § 1129(a)(9).

settlement there is no realistic prospect" of "a meaningful distribution to unsecured creditors.") (emphasis added).

Given these findings, the bankruptcy court was "presented with two options": (1) "a meaningful return" for all unsecured creditors *except* petitioners under the settlement, or (2) "zero" for all unsecured creditors *including* petitioners in the absence of the settlement. Pet. App. 61a. Not surprisingly, after concluding that the Code's priority system applied only to plans, not settlements, Pet. App. 58a, the court chose the former option, Pet. App. 61a.

Petitioners did not challenge any of the bankruptcy court's factual findings as clearly erroneous in either the district court or the Third Circuit—just as they did not challenge any of those findings in their petition to this Court. *See* Pet. App. 40a (district court) ("[Petitioners] largely do not contest the bankruptcy court's factual findings."); Pet. App. 14-15a (Third Circuit) ("[Petitioners] mount no real challenge to the Bankruptcy Court's findings that there was no prospect of a confirmable plan in this case and that conversion to Chapter 7 was a bridge to nowhere."). So petitioners must now live with those findings, which obviously raise the question of what petitioners are doing here.

The Third Circuit honed in on this issue at oral argument below. The court asked petitioners' counsel "what is the remedy if ... you should prevail here, we go to Chapter 7; is that it?" Resps.' Supp. Br., Supp. App. 19a. Counsel responded "*Correct*, because that is the option that ... congress ...," before being interrupted by further questioning. *Id.* (emphasis added). The court then repeated the

question: "So you're not asking for any remedy from us other than it goes to Chapter 7?" *Id.* Counsel's answer was short and to the point: "Correct." *Id.*; *see also id.* at 60a (answering, in response to the question "what is the relief you are seeking here?," "Your Honors, we are simple folks, this case should go to a Chapter 7 trustee. We can't undo the fact that there isn't a nice landing for anyone there.").

The court then pressed counsel to explain how, in light of the bankruptcy court's uncontested findings, petitioners would benefit from conversion to Chapter 7. In that event, the court asked, any money remaining in the bankruptcy estates "goes to the secured creditors, right?" *Id.* at 21a. Counsel responded, "If that's the rules, then that is the rule, yes." *Id.* "And [petitioners] still get nothing?" *Id.* "Correct. If—if there's nothing left in the estate." *Id.*

These exchanges reveal that petitioners are not challenging the settlement of the fraudulent conveyance claim in the expectation of recovering a penny. Rather, petitioners are challenging the settlement because they (or at least their counsel) want an advisory opinion on what they view as the proper operation of the Bankruptcy Code, which they view as important in setting the baseline for negotiations in *other* bankruptcy cases.

Thus, petitioners insisted below that conversion to Chapter 7 would be a victory *regardless* of whether it yielded them any money (which, under the bankruptcy court's uncontested findings, it would not). According to their counsel, "if we undo the settlement and we go to Chapter 7, we're following the code." *Id.* at 19a. Regardless of whether they obtained any money, "[w]e think it's the better advice

to let the code do its job." *Id.* at 22a; *see also id.* at 55a ("We are prejudiced in every bankruptcy where we're told by the financiers, give up your WARN claims outside of this case or you're getting nothing in this bankruptcy. That is now ... the threat to us. And it's been used, base[d] on this case, and it will be used throughout the country."); *id.* at 60a (stating that petitioners are seeking "a stable rule, set of rules that people can count on and negotiate against in bankruptcy."). Counsel for the U.S. Trustee, appearing as *amicus* supporting petitioners below, made the same point: "We're not arguing that ... that the [bankruptcy court's] factual findings are clearly erroneous, what we're arguing is that where the code clearly ... prohibits what was done in this settlement," the settlement must be set aside. *Id.* at 33a.

The problem with this position is that, in the absence of "a proper case or controversy," the federal courts "have no business deciding [a dispute], or expounding the law in the course of doing so." *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 341 (2006). Thus, a long line of cases—culminating in *Steel Co.*—holds that a professed interest in vindicating federal law is insufficient to create an Article III "case" or "controversy." In *Steel Co.*, the Court held that it lacked jurisdiction to entertain a private entity's attempt to prove that a company had violated federal law and was thus liable for civil penalties. Such penalties would not personally benefit the plaintiff, the Court explained, because they would be payable to the United States Treasury. 523 U.S. at 106-07. This Court acknowledged that the plaintiff might derive "great comfort and joy from the fact that the United States Treasury is not

cheated, that a wrongdoer gets his just deserts, or that the Nation's laws are faithfully enforced." *Id.* at 107. But such "psychic satisfaction is not an acceptable Article III remedy because it does not redress a cognizable Article III injury." *Id.*; *see also Lujan v. Defenders of Wildlife*, 504 U.S. 555, 577 (1992); *Simon v. Eastern Ky. Welfare Rights Org.*, 426 U.S. 26, 38-44 (1976); *Linda R.S. v. Richard D.*, 410 U.S. 614, 618 (1973); *Fairchild v. Hughes*, 258 U.S. 126, 129-30 (1922).

Petitioners apparently now understand that they cannot admit that this case is no more than an effort to vindicate their view (or their counsel's view) of how the Bankruptcy Code should operate. So their brief speculates that they might or would have obtained a better settlement if the bankruptcy court had rejected this settlement. *See, e.g.*, Petrs.' Br. 4 ("[T]here is no way to know whether the parties would have settled had [respondents] been required to respect priority."); *id.* at 51 ("[I]t is highly implausible that Sun would have paid *nothing* to achieve the benefits it obtained through the settlement if the bankruptcy court had required that priority be respected.") (emphasis in original).

But that is just wishful thinking. As an initial matter, petitioners have specifically disavowed any interest in "reforming" the settlement, and insisted that their only requested remedy was conversion to a Chapter 7 liquidation. Resps.' Supp. Br., Supp. App. 19-20a, 60a. In any event, as noted above, the bankruptcy court found that no Chapter 11 plan or alternative settlement was feasible, so that the only option to this settlement was conversion to a Chapter 7 liquidation, in which case respondents CIT and

Sun Fund IV would have received all of the estates' assets in short order and unsecured creditors (including petitioners) would have recovered nothing, Pet. App. 56-61a, and petitioners have not challenged those findings.

Thus, as the Third Circuit explained, the notion that petitioners could have achieved a better settlement if the bankruptcy court had rejected this one "rests on [a] counterfactual premise." Pet. App. 21a; *see also id.* ("[T]here is no evidence calling into question the Bankruptcy Court's conclusion that there was 'no realistic prospect' of a meaningful distribution to Jevic's unsecured creditors apart from the settlement under review.") (quoting Pet. App. 58a). Both the district court and the Third Circuit credited the bankruptcy court's factual findings, and this Court should do likewise. This Court does not sit to review factual findings (especially where they have been ratified by two lower courts), *see, e.g.*, *Exxon Co., U.S.A. v. Sofec, Inc.*, 517 U.S. 830, 841 (1996); *Graver Tank & Mfg. Co. v. Linde Air Prods. Co.*, 336 U.S. 271, 275 (1949), and in any event petitioners have not even attempted to prove that those factual findings are clearly erroneous.

In a last-ditch effort to explain what they are doing here, petitioners suggest that if the settlement had been rejected, the Chapter 11 case might have been dismissed outright and they "would have been free to pursue" their own fraudulent conveyance claim against respondents CIT and Sun Fund IV in their capacity as Jevic creditors. Petrs.' Br. 17. That suggestion is unavailing.

As an initial matter, that suggestion runs counter to petitioners' position in this case up to now.

Petitioners have never previously suggested any interest in pursuing a fraudulent conveyance claim against CIT and Sun Fund IV, and never asked the bankruptcy court to dismiss the Chapter 11 case outright in order for them to do so. To the contrary, as noted above, they were repeatedly asked point-blank below what relief they were seeking and unequivocally answered conversion to a Chapter 7 liquidation. *See* Resps.' Supp. Br., Supp. App. 19-20a, 60a. Not until the certiorari stage in this Court did *anyone* advance the theory that rejecting the settlement could theoretically benefit petitioners by leaving them free to pursue their own fraudulent conveyance action—and even then that theory was advanced not by petitioners, but by their *amici*. *See* Law Profs.' Br. 11-13; U.S. Br. 17-18. Because petitioners never challenged the settlement below on this ground, they cannot advance it for the first time in this Court. *See, e.g.*, *OBB Personenverkehr AG v. Sachs*, 136 S. Ct. 390, 397-98 (2015).

Petitioners' failure to advance this theory below was no oversight, as it has no basis in reality. A major issue at the hearing on the settlement was whether a Chapter 7 trustee could locate anyone to pursue the estates' long-shot fraudulent conveyance claim. Petitioners never offered to do so, or to identify contingency counsel who would do so—a point on which the Third Circuit pressed petitioners' counsel repeatedly at the oral argument below, and in response to which they never suggested that they wanted (or had the resources) to pursue the fraudulent conveyance claim themselves or to obtain contingency counsel to do so. *See* Resps.' Supp. Br., Supp. App. 15a, 57a.

If, as the bankruptcy court found, contingency counsel would have to "have his head examined" to pursue that claim on behalf of the estates, Pet. App. 61a, that is true *a fortiori* with respect to pursuing that claim on behalf of petitioners. Both claims, after all, would face the same significant obstacles, *see* Pet. App. 60a, but the potential recovery on behalf of petitioners alone would be far smaller than the potential recovery on behalf of all unsecured creditors. (A claim on behalf of petitioners alone would be limited to the "amount necessary to satisfy" their individual "claim[s]," N.J. Stat. Ann. § 25:2-30(b); *see also id.* § 25:2-29(a)(1), whereas a claim on behalf of the bankruptcy estates could seek an amount necessary to satisfy the claims of *all* creditors.) Thus, petitioners' current suggestion that they might have pursued an individual fraudulent conveyance claim if the bankruptcy court had rejected the settlement—especially when petitioners themselves never raised that possibility in that court—is at best speculative. And a speculative theory cannot be the basis for establishing an Article III "case" or "controversy"; to the contrary, petitioners must prove that their alleged injury is "*likely* to be redressed by a favorable judicial decision." *Spokeo*, 136 S. Ct. at 1547 (emphasis added; internal quotation omitted).

The bottom line here is that petitioners do not like the settlement, but cannot overcome the bankruptcy court's factual findings that there was no feasible alternative that would have left them better off. Indeed, their challenge to the settlement threatens to harm all of the other unsecured creditors without helping petitioners. However important the question presented in the petition, "it is not as important as

observing the constitutional limits set upon courts in our system of separated powers." *Steel Co.*, 523 U.S. at 110. Accordingly, this Court should dismiss this case for lack of jurisdiction.

II. The Bankruptcy Code Neither Authorizes Nor Requires Bankruptcy Courts To Reject Chapter 11 Settlements That Do Not Follow The Code's Priority System.

Turning to the question on which this Court granted certiorari, nothing in the Bankruptcy Code requires bankruptcy courts to reject all Chapter 11 settlements that distribute proceeds "in a manner that violates the statutory priority scheme." Pet. i. Indeed, nothing in the Bankruptcy Code requires bankruptcy courts to review and approve Chapter 11 settlements in the first place. Because the latter question is logically antecedent to the former, *see, e.g.*, *Arcadia, Ohio v. Ohio Power Co.*, 498 U.S. 73, 77 (1990), and is "predicate to an intelligent resolution of the question presented," *Ohio v. Robinette*, 519 U.S. 33, 38 (1996) (internal quotation omitted), respondents will address it first.

A. The Bankruptcy Code Neither Authorizes Nor Requires Bankruptcy Courts To Review Or Approve Chapter 11 Settlements.

Petitioners' argument that bankruptcy courts must reject all Chapter 11 settlements that do not follow the Code's priority system rests on the premise that bankruptcy courts must review and approve such settlements in the first place. That premise is incorrect; nothing in the Bankruptcy Code either authorizes or requires bankruptcy courts to review or approve settlements.

As a threshold matter, this issue was not litigated below, because the Third Circuit has long held to the contrary. In *Martin*, that court held that "[u]nder Bankruptcy Rule 9019, a bankruptcy judge has the authority to approve a compromise of a claim," and articulated a series of factors for the court to consider in doing so. 91 F.3d at 393. The court purported to locate the statutory authority for that Rule in 11 U.S.C. § 363(b)(1), which provides:

> The trustee, after notice and a hearing, may [1] use, [2] sell, or [3] lease, other than in the ordinary course of business, property of the estate.

Id. at 394 (quoting 11 U.S.C. § 363(b)(1), emphasis omitted). Under this view, the settlement of a legal claim represents a "sale" of estate property (*i.e.*, the claim) outside the ordinary course of business. Thus, according to the court, "Section 363 of the Code is the substantive provision requiring a hearing and court approval; Bankruptcy Rule 9019 sets forth the procedure for approving an agreement to settle or compromise a controversy." *Id.* at 394 n.2. In the two decades that *Martin* has been on the books, it has been settled law in the Third Circuit that a Chapter 11 settlement requires a bankruptcy court's approval. *See, e.g., Northview Motors*, 186 F.3d at 350-51 & nn.3,4; *In re Nutraquest, Inc.*, 434 F.3d 639, 644-45 (3d Cir. 2006).

On that foundational point, however, the Third Circuit is incorrect. Indeed, the First Circuit has concluded exactly the opposite, holding that the settlement of a claim is not a "sale" within the meaning of § 363, and thus there is nothing in the Bankruptcy Code that either requires or authorizes a

court to approve a settlement. *See In re Healthco Int'l, Inc.*, 136 F.3d 45, 49-50 & n.4 (1st Cir. 1998). Commentators have recognized this conflict among the circuits. *See, e.g.*, Peter J. Davis, *Settlements as Sales under the Bankruptcy Code*, 78 U. Chi. L. Rev. 999, 999 (2011) ("Circuit courts disagree over whether a settlement of a cause of action should be classified as a sale under § 363."). Petitioners simply gloss over this issue, asserting that "[t]he settlement of an estate cause of action is ..., in substance, a sale of estate property ... subject to the requirements of § 363," and citing the cases on the other side of the split. Petrs.' Br. 33 (citing *In re Moore*, 608 F.3d 253, 263-65 (5th Cir. 2010); *Northview*, 186 F.3d at 350-51 & n.4, and *Martin*, 91 F.3d at 394-95 & n.2).

Both the text and the history of the statute support the First Circuit's position. For starters, the settlement of a cause of action is not a "sale" of property. A "sale" involves the *transfer* of property for consideration. *See, e.g.*, *Webster's Third New Int'l Dictionary* 2003 (1976) (defining "sale" as "a contract transferring the absolute or general ownership of property from one person or corporate body to another for a price"); *Random House Dictionary of the English Language* 1693 (2d ed. 1987) (defining "sale" as a "transfer of property for money or credit"); *Black's Law Dictionary* 1537 (10th ed. 2014) (defining "sale" as "[t]he transfer of property or title for a price"). A settlement involves no such transfer. No one is purchasing a settled cause of action to pursue it; rather, it is being voluntarily extinguished for consideration. *See Healthco*, 136 F.3d at 49. If someone agreed to smash a vase for $100, one would hardly say that she thereby "sold" the vase to someone else.

The statutory history reinforces this straightforward point. The Nation's first permanent federal bankruptcy statute was the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544. That Act remained in place, subject to amendments, until 1978, when Congress repealed and replaced it with the current Bankruptcy Code. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978); *Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1939 (2015).

The 1898 Act included a specific provision, Section 27, that authorized and required judicial reivew of Chapter 11 settlements:

> The receiver or trustee may, *with the approval of the court*, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate.

Bankruptcy Act of 1898 § 27, 30 Stat. at 553-54 (emphasis added), codified at 11 U.S.C. § 50, Supp. App. 1a (repealed). And Congress kept that requirement in place when, in 1938, it substantially amended the 1898 Act. *See* Act of June 22, 1938, Pub. L. No. 77-969 § 27, 52 Stat. 840, 855, codified at 11 U.S.C. § 50, Supp. App. 2a (repealed); *see generally* 1 *Collier on Bankruptcy* ¶ 20.01[i] (Alan N. Resnick ed. 2010 ed.).

When Congress replaced the 1898 Act with the current Bankruptcy Code in 1978, however, it did not enact a counterpart to Section 27. And that was no oversight: a major objective of the 1978 overhaul of bankruptcy law was to *curtail* judicial involvement in the day-to-day administration of the estate. Under the 1898 Act, district courts (sitting as

bankruptcy courts) or their referees exercised substantial control over bankruptcy trustees, and "every important determination in reorganization proceedings receive[d] the 'informed, independent judgment' of the bankruptcy court." *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968) (quoting *National Surety Co. v. Coriell*, 289 U.S. 426, 436 (1933)); *see also* H.R. Rep. No. 95-595, at 88-91 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6049-53.

The 1978 Act broke sharply from that model, and limited judicial control over the management of the estate to preserve the courts' impartiality. Congress thus replaced the prior system with specialized bankruptcy courts to act as "passive arbiters of disputes that arise in bankruptcy cases" rather than micromanagers. H.R. Rep. 95-595 at 107, 1978 U.S.C.C.A.N. at 6069; *see also id.* at 4, 91, 1978 U.S.C.C.A.N. at 5965-66, 6052-53; *see generally Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 53 (1982). These changes significantly increased the autonomy of bankruptcy trustees by "remov[ing] many of the supervisory functions from the judge in the first instance, [and] transfer[ring] most of them to the trustee and to the United States Trustee." H.R. Rep. 95-595 at 4, 1978 U.S.C.C.A.N. at 5966; *see also id.* at 107, 1978 U.S.C.C.A.N. at 6069 ("More responsibility for the administration of cases will be shifted to the trustees that serve in cases.").

In this context, it is impossible to view the repeal of Section 27, without a replacement, as anything other than a decision to remove bankruptcy courts

from the business of reviewing and approving Chapter 11 settlements. When Congress repeals legislation, courts must "presume it intends [the change] to have a real and substantial effect." *Stone v. INS*, 514 U.S. 386, 397 (1995); *see also United States v. Quality Stores, Inc.*, 134 S. Ct. 1395, 1401 (2014). The Code now says *nothing* about judicial review or approval of settlements. And that is certainly not because settlements are rare; to the contrary, "it is an unusual case in which there is not some litigation that is settled between the representative of the estate and an adverse party." *Martin*, 91 F.3d at 393.

It is especially anomalous to suggest that Section 363 should now do the work previously performed by Section 27, because Section 363's precursor—Section 116(3) of the 1938 amendments to the 1898 Act, 11 U.S.C. § 516(3), Supp. App. 2-3a (repealed)—coexisted with Section 27 for forty years. If Section 116(3) authorized and required courts to approve bankruptcy settlements, Section 27 would have been superfluous for all of those years.

And because no provision of the Bankruptcy Code authorizes or requires bankruptcy courts to review and approve Chapter 11 settlements, no statutory standard governs such approval and review. The courts that have held or assumed that bankruptcy courts have such authority under the Code have simply "tak[en] [their] cue" from pre-Code caselaw based on Section 27, without pausing to consider the ongoing vitality of that caselaw. *See, e.g.*, *Martin*, 91 F.3d at 393 (crafting four-factor test based on *TMT Trailer Ferry*, 390 U.S. at 424-25); *Nutraquest*, 434 F.3d at 645 (relying on *TMT Trailer Ferry* and *Drexel*

v. Loomis, 35 F.3d 800, 806 (8th Cir. 1929)); *see generally* 10 *Collier on Bankruptcy* ¶ 9019.02 (collecting cases). Thus, the factors applied in reviewing bankruptcy settlements have no statutory mooring.

Nor does Federal Rule of Bankruptcy Procedure 9019 provide any such mooring. That Rule provides in relevant part that "[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement." Fed. R. Bankr. P. 9019(a). The Rule provides no substantive standard for approving a settlement, which is not surprising because it is merely a procedural rule promulgated by this Court under the Bankruptcy Rules Enabling Act, 28 U.S.C. § 2075. The Rule is based on former Bankruptcy Rule 919, which was the procedural counterpart to Section 27. *See, e.g.*, *Healthco*, 136 F.3d at 50 n.4. In other words, the substantive underpinning is gone, but the Rule lives on. *See, e.g.*, *Iridium*, 478 F.3d at 461 ("Bankruptcy Rule 9019 [is] unique in that it does not have a parallel section in the Code.").

In the absence of a parallel provision in the Code, of course, Rule 9019 cannot provide any substantive authority. *See* 28 U.S.C. § 2075 (Federal Rules of Bankruptcy Procedure "shall not abridge, enlarge, or modify any substantive right"). Indeed, petitioners themselves recognize that "Rule 9019, as a rule of procedure, cannot provide on its own [authority for settling an estate cause of action]," Petrs.' Br. 32, and simply purport to locate the source of such authority in Section 363, even though that Section has its own corresponding procedural rule, Federal

Rule of Bankruptcy Procedure 6004 ("Use, Sale, or Lease of Property").

Congress' decision not to require judicial approval of Chapter 11 settlements does not give parties *carte blanche* to use settlements to circumvent the Code's priority system. Rather, the Code includes other protections to ensure that creditors are not unfairly squeezed out of a recovery. A confirmed plan of reorganization is the goal in almost every Chapter 11 case, *see* 7 *Collier on Bankruptcy* ¶ 1129.01, and the plan itself must still comply with the Code's priority system and in particular the absolute priority rule of § 1129(b)(2)(B)(ii). A settlement that distributes estate assets in a way that harms a priority creditor will make that difficult if not impossible.

Even without judicial review, then, settlements that do not follow the Code's priority system will be reserved for those rare circumstances where, as here, the settlement leaves a passed-over creditor no worse off than the available alternatives and improves the lot of all other unsecured creditors. And if such settlements are deemed to be a problem, Congress may at any time amend the Code to restore the judicial authority and responsibility to review settlements that it repealed in 1978. Meanwhile, courts may not pretend that the repeal never happened and continue reviewing Chapter 11 settlements as they did before 1978.

B. The Bankruptcy Code's Priority System Does Not Apply To Chapter 11 Settlements.

Even if bankruptcy court review and approval of Chapter 11 settlements is required, nothing prevents those courts from "authoriz[ing] the distribution of

settlement proceeds in a manner that violates the statutory priority scheme." Pet. i. The Code's priority system does not apply to Chapter 11 settlements, and petitioners' contrary policy arguments are irrelevant and unavailing.

1. Nothing In The Bankruptcy Code Applies The Priority System To Chapter 11 Settlements.

Nothing in the Code's text extends the Code's priority system to Chapter 11 settlements, as opposed to Chapter 11 plans. The absolute priority rule, as this Court has recognized, is "now on the books as subsection (b)(2)(B)(ii)"—*i.e.*, 11 U.S.C. § 1129(b)(2)(B)(ii). *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 449 (1999). Under that rule, creditors are divided into classes according to the priority of their claims, and the claims of rejecting senior classes must be paid before the claims of junior classes:

> [T]he conditions that a *plan* be fair and equitable with respect to a class includes the following requirements ... With respect to a class of unsecured claims ... the holder of any claim or interest that is junior to the claims of such class will not receive or retain *under the plan* on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added); *see also id.* § 1129(a)(8); *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988). By its plain terms, the rule only applies to a "plan"—and then only to dissenting classes of claims under a plan (not to consenting classes under a plan nor to dissenting

members of consenting classes under a plan). Indeed, Section 1129, in which the rule is codified, is entitled "Confirmation of *plan*" and describes the "requirements" for a court to "confirm a *plan*." 11 U.S.C. § 1129(a) (emphasis added). That is the beginning and the end of the matter: if Congress had wanted the Code's priority system to apply to Chapter 11 settlements as well as Chapter 11 plans, it could and would have said so.

In arguing to the contrary in their petition, petitioners relied on the Fifth Circuit's 1984 decision in *AWECO*. In particular, they seized upon a sentence in *AWECO* in which the Fifth Circuit declared that "'a bankruptcy court abuses its discretion in approving a settlement with a junior creditor unless the court concludes that priority of payment will be respected as to objecting senior creditors.'" Pet. 16 (quoting *AWECO*, 725 F.2d at 298). According to the petition, "there is a square and acknowledged split among the circuits on the question presented," *id.* at 15 (capitalization modified), because *AWECO* "adopted a per se rule under which any distribution of settlement proceeds" must follow the Code's priority system, while the Second Circuit in *Iridium* and the Third Circuit in this case held that Chapter 11 settlements were not governed by the Code's priority system, *id.* at 15-16.

In their merits brief, however, petitioners make no pretense of defending the *AWECO* rule. Indeed, that case appears only once in the argument section of that brief, and then only in a footnote seeking to *distinguish* the case on the ground that "the relevant consideration is not whether the bankruptcy court is approving a settlement." Petrs.' Br. 32 n.6.

It is no surprise that petitioners do not wish to defend the *AWECO* rule on which they relied in their petition (and which was the subject of the alleged circuit split that this Court granted certiorari to review), because that rule is indefensible. The Fifth Circuit did not purport to derive the rule from the statute. Rather, the *AWECO* court "f[ou]nd the *policy arguments* convincing that some extension of the fair and equitable standard [into the realm of Chapter 11 settlements] is proper." 725 F.2d at 298 (emphasis added); *see also id.* ("Our understanding of bankruptcy law's *underlying policies* leads us to make a limited extension of the fair and equitable standard.") (emphasis added); *id.* (approving Chapter 11 settlement that does not follow priority system "contravenes a basic notion of fairness").

Because "a goal" of Chapter 11 is approval of a plan, the Fifth Circuit asserted, that goal should exist throughout a Chapter 11 proceeding; it "does not suddenly appear during the process of approving a plan." *Id.* But that assertion is illogical: just because a Chapter 11 plan must follow the Code's priority system as to dissenting classes of creditors does not mean that every pre-plan component of a Chapter 11 proceeding must follow that priority system. The Fifth Circuit thus missed the point by declaring that "if the [priority system] had no application before confirmation of a reorganization plan, then bankruptcy courts would have the discretion to favor junior classes of creditors so long as the approval of the settlement came before the plan." *Id.* As long as the *plan* follows the priority system, it is immaterial if every individual step on the path to the plan follows the priority system.

The Second Circuit in *Iridium* was, if anything, polite in characterizing the *AWECO* rule as "too rigid." 478 F.3d at 464. The *Iridium* court recognized, with some understatement, that "[w]hen a settlement is presented for court approval apart from a reorganization plan ... the priority rule of 11 U.S.C. § 1129 is not necessarily implicated." *Id.* at 463. The court thus held that a Chapter 11 settlement need not follow the Code's priority system. Still, the court identified "a heightened risk that the parties to a settlement may engage in improper collusion," and thus characterized compliance with the priority system as "the most important factor for the bankruptcy court to consider" in reviewing a Chapter 11 settlement. *Id.* at 464; *see also id.* ("The court must be certain that parties to a settlement have not employed a settlement as a means to avoid the priority strictures of the Bankruptcy Code."). The Third Circuit in this case adopted that standard—without objection from petitioners and without dissent. *See* Pet. App. 19a, 24a.

Petitioners, however, now ask this Court to reject that standard, and hold that a Chapter 11 settlement must follow the Code's priority system. They make no pretense that this position has any basis in the Code's text. To the contrary, they argue that it is "irrelevant" that "nothing in the Code in so many words requires compliance with the priority scheme when a bankruptcy court approves a settlement of estate litigation." Petrs.' Br. 22. Rather, they assert, "[t]he Code cannot sensibly be read" to allow Chapter 11 settlements that do not follow the Code's priority system, and to do so would "fail[] to honor th[e] basic precept" that statutory provisions must be

understood in context. Petrs.' Br. 22-23, 41. In essence, they contend, a requirement that a Chapter 11 settlement must follow the Code's priority system is to be found in the Code's penumbras, emanating from the general policies underlying specific Code provisions.

That is simply not the way this Court interprets statutes, particularly not statutes as "'meticulous' and 'detailed'" as the Bankruptcy Code. Petrs.' Br. 21 (quoting *Law v. Siegel*, 134 S. Ct. 1188, 1196 (2014)). Petitioners are not asking this Court to interpret any particular statutory term in context, but instead to invent a new statutory requirement.

Petitioners' *amicus* the United States at least refrains from asking the Court to impose a statutory requirement with no basis in the statute. Thus, the United States argues that the Code's priority system, set forth in 11 U.S.C. § 507, governs Chapter 11 settlements by virtue of 11 U.S.C. § 103(a). *See* U.S. Br. 3, 13, 18, 24, 26. That argument is based on the following syllogism: (1) the Code's priority system is set forth in § 507, which is part of Chapter 5, (2) Section 103(a) states in relevant part that Chapter 5 applies in a case under Chapter 11, so therefore (3) the Code's priority system applies to a settlement in a case under Chapter 11. *See id.*

As the Third Circuit explained, that syllogism is flawed. Pet. App. 15-17a & n.7. Section 507 describes the priority of particular unsecured "expenses and claims," but does not specify the circumstances under which bankruptcy courts are required to apply those priorities. 11 U.S.C. § 507. That is why Congress specified that the priorities set forth in § 507 apply to dissenting classes of creditors

under plans, *see id.* § 1129(b)(2)(B)(ii), and to the payment of unsecured claims in a Chapter 7 liquidation, *see id.* § 726(a) ("[P]roperty of the estate shall be distributed ... first, in payment of claims of the kind specified in, and in the ordered specified in, section 507 of this title ..."). Section 507 does not, of its own force, impose its priority system upon plans (or anything else).

Nor does Section 103(a) do the job. That provision generally provides that "chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title," 11 U.S.C. § 103(a), without specifically addressing to *what* in the latter chapters the former chapters apply. Again, that is why, when Congress wanted to specify that Chapter 11 plans and Chapter 7 liquidations must follow the § 507 priority system, it said so in Chapter 11, *see* 11 U.S.C. §§ 1129(a)(9), (b)(2)(B)(ii), and in Chapter 7, *see* 11 U.S.C. § 726. If Section 103(a) means that a Chapter 11 settlement must follow the Code's priority system, "there would have been no need for Congress to codify the absolute priority rule specifically in the plan confirmation context." Pet. App. 16a n.7.

Petitioners' invocation of the canon that "'the specific governs the general'" is thus inexplicable. Petrs.' Br. 38 (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992)). The "specific provisions governing distribution of estate assets" to which petitioners point over and over again in their brief—11 U.S.C. §§ 726 and 1129—do not mention settlements. Petrs.' Br. 38. That simple point distinguishes *United Savings Ass'n of Tex. v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 373 (1988), where a creditor attempted to use broad

language from the Code's general provisions to circumvent the Code's "carefully drawn" limits on a specific issue (the types of creditors who could seek post-petition interest). If anything, the canon that the specific governs the general *refutes* petitioners' argument here, given that they are relying on the Code's general priority system to circumvent the specific provision of Chapter 11 applying that system to plans, not settlements.

The absence of any provision applying the Code's priority system to Chapter 11 settlements likewise distinguishes *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065 (2012). The debtors there tried to use broad language in the Code to circumvent a specific requirement. *Id.* at 2070. Allowing settlements that do not follow the Code's priority system in limited circumstances, in contrast, would not circumvent any provision of the Code for the simple reason that no provision of the Code applies the priority system to settlements.

At bottom, petitioners thus frame the issue precisely backwards by complaining that the Third Circuit "failed to cite any provision of the Code permitting ... a departure" from the Code's priority system. Petrs.' Br. 32. The key point here is that *petitioners* have failed to cite any provision of the Code applying the priority system to Chapter 11 settlements in the first place. As the Third Circuit recognized, and petitioners largely concede, the Code by its plain terms does not extend that priority system to Chapter 11 settlements. If petitioners do not like that result, they are of course free to ask Congress to amend the Code.

2. There Is No "Common Law" Basis For Applying The Bankruptcy Code's Priority System To Chapter 11 Settlements.

Acknowledging that nothing in the Code applies the priority system to Chapter 11 settlements, some of petitioners' *amici* argue that "the absolute priority rule applies to settlements as a matter of common law, not statute." Law Profs.' Br. 12 n.10 (citing *TMT Trailer Ferry*, 390 U.S. at 432); *see also* Petrs.' Br. 31-32 & n.6 (relying on *TMT Trailer Ferry*). That argument is meritless. Congress has enacted a comprehensive and detailed statute, the Bankruptcy Code, to govern bankruptcy cases, and courts thus must work "within the confines" of that statute. *Law*, 134 S. Ct. at 1194. Thus, courts cannot "take it upon themselves" to invent common-law rules to address any perceived shortcomings in the Code. *United States v. Noland*, 517 U.S. 535, 543 (1996); *see also Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 24-25 (2000) ("Bankruptcy courts ... are limited to what the Bankruptcy Code itself provides.").

In any event, the common-law rule that petitioners and their *amici* purport to derive from *TMT Trailer Ferry* never existed and certainly does not exist today. *TMT Trailer Ferry*, according to petitioners, holds that a settlement "must be 'fair and equitable' to all creditors" and treated that phrase as "a term of art incorporating 'the absolute priority doctrine.'" Petrs.' Br. 32 n.6 (quoting *TMT Trailer Ferry*, 390 U.S. at 424, 441)); *see also* Illinois Br. 20-21.

As an initial matter, *TMT Trailer Ferry* was decided under the 1898 Bankruptcy Act, not the 1978 Bankruptcy Code, and proceeded from the premise,

rejected in the Code, that "it is essential that every important determination in reorganization proceedings," including settlements, "receive the 'informed, independent judgment' of the bankruptcy court." 390 U.S. at 424 (quoting *Coriell*, 289 U.S. at 436). *TMT Trailer Ferry* did not purport to announce any general rules of federal common law, but instead to interpret and apply specific provisions of the 1898 Act.

In any event, petitioners' description of *TMT Trailer Ferry* fails on its own terms. This Court there used the phrase "fair and equitable" in two different contexts, and in each context ascribed a different meaning to that term. Petitioners and their *amici* conflate the two, as underscored by their quotation of two separate passages separated by almost twenty pages of text.

TMT Trailer Ferry first held that, under the 1898 Act, a bankruptcy court must "determine that a proposed compromise forming part of a reorganization plan is fair and equitable," and that this inquiry requires the judge to "compare the terms of the compromise with the likely rewards of the litigation." *TMT Trailer Ferry*, 390 U.S. at 424-25. The Court then held that the bankruptcy court in that case had not, before approving the settlement, "adequate[ly] and intelligent[ly]" considered the merits of the settled claims, "the difficulties of pursuing them," and "the fairness of the terms of the settlement." *Id.* at 434. When discussing the propriety of the settlement, not once did the Court allude to the absolute priority rule.

Seventeen pages after announcing a "fair and equitable" standard for settlements incorporated into

a plan of reorganization, *see id.* at 424, this Court turned to the merits of the proposed plan of reorganization itself, *see id.* at 441-53. And it was in *this* context that the Court separately stated that courts could not confirm a proposed plan "unless it is found to be 'fair and equitable,'" a standard that in the plan context "incorporates the absolute priority doctrine." *Id.* at 441. (And even then, none of the flaws this Court identified in the plan had anything to do with the absolute priority rule. *See id.* at 441-53.) The Court thus added the absolute priority rule as a gloss on the term "fair and equitable" *only* in the plan confirmation context. Accordingly, nothing in *TMT Trailer Ferry* stands for the proposition that a Chapter 11 settlement must comply with the Code's priority system outside the context of plan confirmation, and certainly not as a matter of "common law" divorced from the Code.

3. Petitioners' Policy Arguments Are Misguided.

Finally, petitioners and their *amici* argue at length that allowing settlements that do not follow the Code's priority system is bad policy. *See, e.g.*, Petrs.' Br. 45-46, 49-55; Br. of Loan Syndications & Trading Ass'n (LSTA) 3-17; Br. of National Employment Law Project (NELP) *et al.* 12-14; Law Profs.' Br. 24-27; Illinois Br. 26-29. The short answer is that these policy arguments "are for the consideration of Congress, not the courts." *RadLAX*, 132 S. Ct. at 2073.

In any event, petitioners' policy arguments fail on their own terms. As recognized by the Second Circuit in *Iridium* and the Third Circuit here, *AWECO*'s *per se* rule that Chapter 11 settlements

must follow the Code's priority system "cannot accommodate the dynamic status of some pre-plan bankruptcy settlements." *Iridium*, 478 F.3d at 464; *see also* Pet. App. 19-20a. This is a case in point. Petitioners' objection to the settlement would have left *all* unsecured creditors (including petitioners) worse off, because *no one* (including petitioners) was willing to continue pursuing the fraudulent conveyance claim, and a Chapter 7 liquidation would have put all of the estates' money in the pockets of secured creditors CIT and Sun Fund IV. By rejecting petitioners' objection, the bankruptcy court thus allowed over 1,000 unsecured creditors (including administrative and priority creditors like federal and state taxing authorities), who would have recovered *nothing* if petitioners had prevailed, to receive full or partial payment of their claims. *See* Pet. App. 39a.[3] Petitioners chose to "hold out" on the settlement in the hope that they would receive full compensation for their WARN claims against SCPI—a hope that all other participants recognized as unrealistic, and

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[3] It is an open question, moreover, whether these unsecured creditors could be forced at this late date (more than three years after they received their share of the settlement proceeds) to disgorge those proceeds. Respondents argued below that, wholly apart from the merits, these appeals are equitably moot in light of the substantial consummation of the settlement. *See, e.g., Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180, 185 (3d Cir. 2001); *In re Chateaugay Corp.*, 988 F.2d 322, 325 (2d Cir. 1993). Because the Third Circuit affirmed the bankruptcy court on the merits, it did not reach that issue. Accordingly, if petitioners were to prevail in this Court, the case would have to be remanded for the Third Circuit to address the equitable mootness argument in the first instance.

which later proved to be unrealistic when the courts dismissed petitioners' WARN claims against SCPI.

Given the dynamic nature of a bankruptcy case up until plan confirmation, it makes sense for the Bankruptcy Code to leave bankruptcy courts more flexibility when approving Chapter 11 settlements than when confirming Chapter 11 plans. As the Second Circuit explained in *Iridium*, it is difficult if not impossible to apply the priority system to a proposed settlement "when the nature and extent of the Estate and the claims against it are not yet fully resolved." 478 F.3d at 464. A flexible standard better accounts for these difficulties than *AWECO*'s *per se* rule.

Indeed, measuring each and every proposed settlement against the Code's priority system, as petitioners advocate, makes little sense. The priority system exists to ensure that a Chapter 11 plan or Chapter 7 liquidation *as a whole* fairly and equitably distributes a debtor's assets to its creditors. Insisting that each individual settlement and its proposed distribution of assets satisfies that same standard when considered in isolation does not further that interest. A particular settlement that does not follow the Code's priority system can be offset by other components of a plan.

To say that the Code's priority system does not apply of its own force to Chapter 11 settlements, of course, is not to say that the Code's priority system is *irrelevant* to settlements. To the contrary, the Third Circuit "agree[d] with the Second Circuit's statement that compliance with the Code priorities *will usually be dispositive* of whether a proposed settlement" is acceptable. Pet. App. 20a (emphasis added; citing

Iridium, 478 F.3d at 455). In doing so, the Third Circuit held "bankruptcy courts may approve settlements that deviate from the priority scheme of § 507 of the Bankruptcy Code *only* if they have 'specific and credible grounds' to justify [the] deviation," and observed that such deviations are "likely to be justified only rarely." *Id.* at 21a, 23a (brackets in original); *see also id.* at 2a (holding courts should approve settlements that do not follow the Code's priority system only in a "rare case"). Thus, the Third Circuit held that the bankruptcy court here acted within its discretion in approving this settlement *only* because the court had made detailed factual findings that "there was 'no realistic prospect' of a meaningful distribution to anyone but the secured creditors unless the settlement were approved because the traditional routes out of Chapter 11 bankruptcy were impracticable." *Id.* at 8a; *see also id.* at 4-9a, 21-23a.

Petitioners and their *amici* predict that limiting priority-skipping settlements to rare cases will prove unworkable because it "is simply not clear as to what should trigger similar deviations in the future." Law Profs.' Br. 22; *see also id.* at 2; Petrs.' Br. 52. That is simply not true. The Third Circuit announced two specific limitations on a bankruptcy court's authority in this context. Courts cannot approve Chapter 11 settlements that do not follow the Code's priority system (1) "when they are used to circumvent the plan confirmation process or conversion to Chapter 7," Pet. App. 14a, or (2) if they increase the "share[] of the estate" distributed to one group of creditors "at the expense of other creditors," Pet. App. 20-21a. These restrictions sharply limit the universe of permissible settlements that do not follow the Code's

priority system to "rare" cases like this one. Pet. App. 2a, 12a.

Here, as the Third Circuit recognized, both of these limitations were satisfied. The settlement was not an attempt to circumvent the requirements for confirming a Chapter 11 plan, because no such plan was feasible. *See* Pet. App. 21a. And the settlement could not be said to have allocated funds to junior creditors at petitioners' "expense" in light of the bankruptcy court's undisputed findings that the only relief petitioners requested (conversion to a Chapter 7 liquidation) would have left all the other unsecured creditors worse off while leaving petitioners no better off. *Id.* "This disposition, unsatisfying as it was, remained the least bad alternative." *Id.*

Petitioners and their *amici* insist that bankruptcy courts must reject even settlements that maximize value for creditors to prevent such courts from blessing collusive settlements. *See* Petrs.' Br. 53-55; *see also* Illinois Br. 24, 27; NELP Br. 18-22; Law Profs.' Br. 22, 24-25. As the Third Circuit explained in rejecting that argument, "[w]e doubt that our national bankruptcy policy is quite so nihilistic and distrustful of bankruptcy judges." Pet. App. 23a. Bankruptcy courts, subject to review by Article III courts, are certainly capable of determining whether a Chapter 11 settlement represents an impermissible attempt to circumvent the requirements for confirming a Chapter 11 plan or for improperly evading the Code's priority system.

Similarly unavailing is the States' concern that allowing Chapter 11 settlements that do not follow the Code's priority system will open the floodgates to settlements that skip tax-related priorities, *see*

Illinois Br. 27, even though the settlement here resulted in a recovery for priority tax creditors who otherwise would have recovered nothing, *see* Pet. App. 39a. It is hard to imagine any "specific and credible grounds," Pet. App. 21a, that would justify distributing assets to more junior creditors at the expense of priority tax creditors.

Petitioners thus present this Court with a false dichotomy: either a Chapter 11 settlement must invariably follow the Code's priority system, or a Chapter 11 settlement is subject to no limitations at all. *See* Petrs.' Br. 47. That argument fails to appreciate the need for flexibility in Chapter 11 settlements—a need so pressing that, as noted above, Congress repealed the provision authorizing judicial review of Chapter 11 settlements altogether.

Petitioners and their *amici* ultimately fall back on the argument that "a firm and certain priority rule," NELP Br. 22, is "the foundation of the bankruptcy system," Law Profs.' Br. 1; *see also* Petrs.' Br. 52-53. But that argument is based on an idealized version of the absolute priority rule that bears scant resemblance to reality. In fact, the absolute priority rule is neither absolute nor a rule; it is (and always has been) riddled with "widespread" exceptions that are "core to the normal science of corporate reorganizations." Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 Va. L. Rev. 1235, 1240, 1250-64, 1280-87 (2013); *see also* Stephen J. Lubben, *The Overstated Absolute Priority Rule*, 21 Fordham J. of Corp. & Fin. L. 581, 583-84 (2016); Edward H. Levi & James Wm. Moore, *Bankruptcy & Reorganization: A Survey of Changes, III*, 5 U. Chi.

L. Rev. 398, 408 (1938) ("The absolute theory of priority ... is entirely unrealistic in the reorganization of a large company.").

As just one example, courts routinely approve the payment of pre-petition wages to employees at the outset of a case. *See, e.g.*, *Cybergenics*, 330 F.3d at 574 n.8. Those employees thereby jump ahead of administrative creditors, other priority creditors, and even secured creditors in a case (like this one) where the debtor is worth less than the secured creditor is owed. *See* Lubben, *The Overstated Absolute Priority Rule*, 21 Fordham J. of Corp. & Fin. L. at 597; Douglas G. Baird, *Elements of Bankruptcy Law* 233 (6th ed. 2014). Petitioners and their *amici* thus have it exactly backwards by arguing that allowing settlements that do not follow the Code's priority system would harm "employees with unpaid wages and benefits." NELP Br. 1, 18-19; *see also* Petrs.' Br. 45-47. Petitioners received millions of dollars in unpaid wages and benefits from the debtors' estates, even though they were unsecured creditors who, under a strict application of the priority rule, would not be entitled to a penny unless and until secured creditors like respondents CIT and Sun Fund IV and all administrative creditors were paid in full. *See* JA206, 226-27. Petitioners, in short, should be careful what they wish for, because the legal regime they propose would leave them much worse off.

And the payment of employees' pre-petition wages is not the only way in which courts routinely deviate from the Code's priority system outside the plan context. Like employees, so-called "critical vendors" whose goods or services are essential to a debtor's post-petition success not infrequently receive

payments for their pre-petition invoices. *See, e.g.*, Lubben, *The Overstated Absolute Priority Rule*, 21 Fordham J. of Corp. & Fin. L. at 596; Baird, *Elements of Bankruptcy*, at 233-34. And yet other creditors move to the front of the line by "rolling up" their unsecured or undersecured pre-petition debt into post-petition debtor-in-possession loans that must be repaid before *any* pre-petition debt. *See* Roe & Tung, *Breaking Bankruptcy Priority*, 99 Va. L. Rev. at 1250-51; *see also* 11 U.S.C. §§ 364, 1129(a)(9). Petitioners thus not only overstate the "certainty" that the Code's priority system provides, Petrs.' Br. 52, but propose a far-reaching and atextual expansion of the Code's priority system that could significantly destabilize many "central features of modern bankruptcy practice," Roe & Tung, *Breaking Bankruptcy Priority*, 99 Va. L. Rev. at 1243.

Similarly unavailing (although revealing) is petitioners' complaint that the decision below will reduce creditors' "leverage" in future negotiations because "[t]he background threat" of a settlement that does not follow the Code's priority system "will hang over the parties' bargaining." Petrs.' Br. 53. That is what this case is really about: creditors' concern about preserving their bargaining "leverage" in *other* cases. But, as a policy matter, the "leverage" argument cuts precisely the other way: as this case illustrates, petitioners' *per se* rule would give the creditors *all* the leverage, and would allow a single holdout creditor to block a settlement that would benefit the debtors and other creditors by demanding payment in full even where that would destroy any hope of maximizing value to *all* creditors.

Even in the plan context, creditors do not enjoy the degree of leverage petitioners seek here. The Code's class voting rules for plans prevent a minority of holdout creditors from exercising a veto over a plan that even most similarly situated creditors support. *See* 11 U.S.C. §§ 1126(c) (deeming an entire class of creditors to accept their treatment under a proposed plan despite the objection of some class members if the plan has sufficiently broad support within the class); 1129(a)(8)(A) (a class of creditors, not each individual member of that class, must accept a plan). Petitioners, in contrast, would allow a single holdout WARN claimant to scuttle a Chapter 11 settlement even if all other creditors *and even all other WARN claimants* supported the deal. This highlights the folly of petitioners' *per se* rule and the danger of importing *only one aspect* of the Code's carefully calibrated plan confirmation process into the settlement context.

III. Whether The Bankruptcy Code Authorizes "Structured Dismissals" Of Chapter 11 Cases Is Not Properly Presented Here.

Presumably because petitioners understand that they cannot defend their side of the circuit conflict that they petitioned this Court to resolve, they now try to change the subject. Literally. They asked this Court to review this case to resolve an alleged circuit conflict between the Fifth Circuit in *AWECO*, on the one hand, and the Second Circuit in *Iridium* and the Third Circuit in this case, on the other, on the question whether Chapter 11 settlements (as opposed to plans) must follow the Code's priority scheme. *See* Pet. 15 ("There is a square and

acknowledged split among the circuits on the question presented.") (capitalization modified).

Petitioners have now changed the question presented to replace a question about judicial approval of Chapter 11 settlements with a question about termination of Chapter 11 cases through "structured dismissals." *Compare* Pet. i ("Whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme.") (emphasis added) *with* Petrs.' Br. i ("Whether a Chapter 11 case may be terminated by a 'structured dismissal' that distributes estate property in violation of the Bankruptcy Code's priority scheme.").

That is a manifest violation of this Court's Rules. In particular, the Rules specify that "[t]he phrasing of the questions presented [in the merits briefs] need not be identical with that in the petition for a writ of certiorari or the jurisdictional statement, but the brief may not raise additional questions or *change the substance of the questions* already presented in those documents." U.S. S. Ct. R. 24.1(a) (emphasis added); *see also* U.S. S. Ct. R. 14(a) ("Only the questions set out in the petition, or fairly included therein, will be considered by the Court.").

There can be no doubt that petitioners are seeking to "change the substance" of the question presented in their petition, on which this Court granted review. As noted above, the petition asked this Court to resolve the alleged conflict between the Fifth Circuit's decision in *AWECO*, on the one hand, and the Second Circuit's decision in *Iridium* and the Third Circuit's decision in this case, on the other. But neither *AWECO* nor *Iridium* involved a

structured dismissal, so the validity of a structured dismissal cannot be said to be logically antecedent to or fairly included in the question presented. Not every distribution of an estate's property outside the context of a plan will necessarily entail a structured dismissal (or a settlement); to the contrary, petitioners themselves benefited from distributions of the estate's assets that did not involve a plan or a settlement (and did not follow the Code's priority system) when they received millions of dollars from the estate as compensation for pre-petition wages and benefits. *See* JA206, 226-27.

Indeed, respondents pointed out in their brief in opposition that "[t]he petition ... does not present the question whether the Bankruptcy Code permits structured dismissals under Chapter 11." Br. in Opp. 23 n.4 (citing Pet. i); *see also* Resps.' Supp. Br. 3 n.1. Petitioners did not dispute that point in their reply brief, but instead doubled down on their argument that this Court's review was warranted because "the courts of appeals are openly divided" on the question whether a Chapter 11 settlement must follow the Code's priority system. Reply to Br. in Opp. 3 (capitalization modified).

There is no mystery what is going on here: petitioners sought this Court's review based on an alleged circuit conflict on Issue "A," but once review was granted, Issue A went out the window and was replaced by Issue "B." This Court should not tolerate such transparent "bait-and-switch tactics." *City & County of San Francisco v. Sheehan*, 135 S. Ct. 1765, 1779 (2015) (Scalia, J., joined by Kagan, J., concurring in part and dissenting in part); *see generally Norfolk S. Ry. v. Sorrell*, 549 U.S. 158, 163-

64 (2007); *Yee v. City of Escondido*, 503 U.S. 519, 534-38 (1992).

It is implausible that this Court would have taken this case to review the validity of structured dismissals, which has only been addressed by a *single* federal court of appeals—the Third Circuit in the decision below. *See* Pet. App. 12-15a. As that court explained, the Bankruptcy Code "explicitly authorizes the bankruptcy court to alter the effect of dismissal 'for cause'—in other words, the Code does not strictly require dismissal of a Chapter 11 case to be a hard reset." Pet. App. 14a (citing 11 U.S.C. § 349(b)); *see also* 11 U.S.C. § 1112(b). And the Third Circuit did not broadly bless the use of structured dismissals; to the contrary, that court held only that the bankruptcy court did not abuse its discretion by dismissing this particular case "for cause" under § 349(b), given the absence of "a showing that [the] structured dismissal has been contrived to evade the procedural protections and safeguards of the plan confirmation or conversion processes." Pet. App. 15a.

There is no disagreement among the courts of appeals on this issue, and this Court does not ordinarily grant review to address a novel and far-reaching issue of federal law that has not first percolated among the federal courts of appeals. Because petitioners "induce[d] [this Court] to grant certiorari," *Sheehan*, 135 S. Ct. at 1779 (Scalia, J., joined by Kagan, J., concurring in part and dissenting in part), by focusing on an alleged circuit split on the question whether bankruptcy courts must reject Chapter 11 settlements that do not follow the Code's priority system, that question (or the logically antecedent question whether

bankruptcy courts must review Chapter 11 settlements at all) is all that this Court should address if it reaches the merits here.

CONCLUSION

For the foregoing reasons, this Court should dismiss for lack of jurisdiction or, in the alternative, affirm the judgment.

October 12, 2016

Respectfully submitted,

PETER S. PARTEE, SR.
RICHARD P. NORTON
HUNTON & WILLIAMS LLP
200 Park Avenue
52nd Floor
New York, NY 10166
(212) 446-4800

Counsel for Respondent The CIT Group/Business Credit, Inc., as Agent for the Lender Group

DOMENIC E. PACITTI
LINDA RICHENDERFER
KLEHR HARRISON HARVEY BRANZBURG LLP
919 N. Market St.,
Suite 1000
Wilmington, DE 19801
(302) 426-1189

Counsel for Respondents Jevic Holding Corp., Jevic Transportation, Inc. & Creek Road Properties, LLC

CHRISTOPHER LANDAU, P.C.
Counsel of Record
JAMES P. GILLESPIE, P.C.
JASON M. WILCOX
KIRKLAND & ELLIS LLP
655 Fifteenth St., N.W.
Washington, DC 20005
(202) 879-5000
clandau@kirkland.com

Counsel for Respondents Sun Capital Partners, Inc., Sun Capital Partners IV, LP & Sun Capital Partners Management IV, LLC

ROBERT J. FEINSTEIN
JAMES E. O'NEILL
PACHULSKI STANG ZIEHL & JONES LLP
919 N. Market St., 17th fl.
P.O. Box 8705
Wilmington, DE 19899
(302) 652-4100

Counsel for Respondent Official Committee of Unsecured Creditors

SUPPLEMENTAL APPENDIX

SUPPLEMENTAL APPENDIX CONTENTS

Bankruptcy Act of 1898, 55th Cong., 2d Sess., 30 Stat. 544 (1898) (excerpts) 1a

Act of June 22, 1938, 75th Cong. 3rd Sess., 52 Stat. 840 (1938) (excerpts) 2a

Bankruptcy Act of 1898
55th Cong., 2d Sess.,
30 Stat. 544 (1898)

CHAP. 541—An Act to establish a uniform system of bankruptcy throughout the United States.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* * *

CHAPTER IV

COURTS AND PROCEDURE THEREIN

* * *

SEC. 27. COMPROMISES.—The trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate.

Act of June 22, 1938
75th Cong., 3rd Sess.,
52 Stat. 840 (1938)

AN ACT

To amend an Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, and Acts amendatory thereof and supplementary thereto; and to repeal section 76 thereof and all Acts and parts of Acts inconsistent therewith.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That sections 1 to 11, inclusive; 14; 15; 17 to 29, inclusive; 31; 32; 34; 35; 37 to 42, inclusive; 44 to 53, inclusive; and 55 to 72, inclusive, of an Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1989, as amended, are hereby amended; and sections 12, 13, 73, 74, 77A, and 77B are hereby amended and incorporated as chapters X, XI, XII, XIII, and XIV; said amended sections to read as follows:

* * *

CHAPTER IV—COURTS AND PROCEDURE THEREIN

* * *

"SEC. 27. COMPROMISES.—The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate.

* * *

CHAPTER X—CORPORATE REORGANIZATIONS

* * *

"ARTICLE III—JURISDICTION AND POWERS OF COURT

* * *

"SEC. 116. Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court—

"(1) permit the rejection of executory contracts of the debtor, except contracts in the public authority, upon notice of the parties to such contracts and to such other parties in interest as the judge may designate;

"(2) authorize a receiver, trustee, or debtor in possession, upon such notice as the judge may prescribe and upon cause shown, to issue certificates of indebtedness for cash, property, or other consideration approved by the judge, upon such terms and conditions and with such security and priority in payment over existing obligations, secured or unsecured, as in the particular case may be equitable;

"(3) authorize a receiver or a trustee or a debtor in possession, upon such notice as the judge may prescribe and upon cause shown, to lease or sell any property of the debtor, whether real or personal, upon such terms and conditions as the judge may approved; and

"(4) in addition to the relief provided by section 11 of this Act, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor.